100TH CONGRESS
2d Session
HOUSE OF REPRESENTATIVES
REPORT
100-964

VETERANS' HOME LOAN MORTGAGE INDEMNITY ACT OF 1988

SEPTEMBER 23, 1988.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. MONTGOMERY, from the Committee on Veterans' Affairs, submitted the following

REPORT

[To accompany H.R. 5221]

[Including cost estimate of the Congressional Budget Office]

The Committee on Veterans' Affairs, to whom was referred the bill (H.R. 5221) to amend title 38, United States Code, with respect to the housing loan program carried out under chapter 37 of such title, and for other purposes, having considered the same, reports favorably thereon with an amendment, by unanimous voice vote, and recommends that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Veterans' Home Loan Mortgage Indemnity Act of 1988".

SEC. 2. ESTABLISHMENT OF SPECIAL INDEMNITY FUND AND LOAN FEE.

(a) SPECIAL INDEMNITY FUND.—(1) Chapter 37 of title 38, United States Code, is amended by adding the following new section after section 1824:

"§ 1824A. Mortgage indemnity fund

"(a) There is hereby established in the Treasury of the United States a revolving fund known as the Veterans' Administration Mortgage Indemnity Fund (hereinafter referred to as the 'Indemnity Fund').

"(b) The Indemnity Fund shall be available to the Administrator for all operations (other than administrative expenses) carried out with respect to guaranteed or insured housing loans for which a fee is collected under section 1829 of this title on or after the effective date of the Veterans' Home Loan Mortgage Indemnity Act

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of 1988, other than loans to which section 1814 of this title applies and which were originally guaranteed or insured before such effective date.

"(c)(1) All fees collected under such section 1829 on or after such effective date shall be credited to the Indemnity Fund, other than fees collected with respect to loans to which section 1814 of this title applies and which were originally guaranteed or insured before such effective date.

"(2) There shall also be credited to the Indemnity Fund—

"(A) for each housing loan guaranteed or insured under this chapter for which a fee is collected under section 1829 of this title on or after such effective date an amount equal to 0.25 percent of the original amount of such loan for each of the three fiscal years beginning with the fiscal year in which such fee is collected;

"(B) all collections of principal and interest and the proceeds from the use of property held, or from the sale of property disposed of, with respect to loans to which subsection (b) of this section applies; and

"(C) all income from the investments described in subsection (d) of this section.

"(d)(1) The Secretary of the Treasury shall invest the portion of the Indemnity Fund that is not required to meet current payments made from the Indemnity Fund, as determined by the Administrator, in obligations of the United States or in obligations guaranteed as to principal and interest by the United States.

"(2) Such obligations shall have maturities suitable to the needs of the Indemnity Fund, as determined by the Administrator, and shall bear interest at rates determined by the Secretary of the Treasury, taking into consideration current market yields on outstanding marketable obligations of the United States of comparable maturities.".

(2) The table of sections of subchapter III of chapter 37 of such title is amended by inserting after the item for section 1824 the following new item:

"1824A. Mortgage indemnity fund.".

(b) LOAN FEE.—Section 1829 of such title is amended to read as follows:

"§ 1829. Loan fee

"(a)(1) Except as provided in subsections (c) and (d), a fee shall be collected from each veteran obtaining a housing loan guaranteed or insured under this chapter, and from each person obtaining a loan under section 1833(a), and no such loan may be guaranteed, made, or insured under this chapter until the fee payable under this section has been remitted to the Administrator.

"(2) The amount of such fee shall be 1.25 percent of the total loan amount, except that—

"(A) in the case of a loan made under section 1833(a), the amount of such fee shall be one percent of the total loan amount; and

"(B) in the case of a guaranteed or insured loan for a purchase or construction with respect to which the veteran has made a downpayment of not less than 5 percent of the total purchase price or construction cost, the amount of such fee shall be 0.75 percent of the total loan amount.

"(3) The amount of the fee may be included in the loan and paid from the proceeds thereof.

"(b) Except as provided in subsections (c) and (d), a fee shall be collected from a person assuming a loan to which section 1814 of this title applies. The amount of the fee shall be equal to one-half of one percent of the balance of the loan on the date of the transfer of the property.

"(c) A fee may not be collected under this section from a veteran who is receiving compensation (or who but for the receipt of retirement pay would be entitled to receive compensation) and whose disability is rated at not less than 30 percent or from a surviving spouse of any veteran (including a person who died in the active military, naval, or air service) who died from a service-connected disability.

"(d) After September 30, 1989, a fee may not be collected under this section with respect to a loan made under section 1833(a) or to which section 1814 of this title applies.".

(c) LIABILITY.—Section 1803 of such title is amended by adding at the end the following:

"(e) Any veteran who pays a fee under section 1829 of this title, or is exempted under section 1829(c) from paying such fee, on or after the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1988 with respect to a housing loan (other than a loan made under section 1833(a) or a loan for which a fee is collected

under section 1829(b)) shall have no liability to the Administrator with respect to the loan for any loss resulting from any default of the veteran.".

(d) CONFORMING AMENDMENTS.—(1) Section 1824 of such title is amended—

(A) in subsection (b), by inserting the following before the period at the end of the first sentence: "and the operations carried out with the Indemnity Fund established by section 1824A"; and

(B) in subsection (c)—

(i) by inserting after "title" in clause (2) the following: "before the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1988, except that fees collected under subsection (b) of such section 1829 on or after such effective date with respect to loans which were originally guaranteed, made, or insured before such effective date shall also be deposited in the Fund"; and

(ii) by inserting after "chapter" in clause (3) the following: "with respect to housing loans guaranteed or insured under this chapter before the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1988".

(2) Section 1832(a)(1) of such title is amended by striking out "If" in the last sentence and inserting in lieu thereof "Except as provided in section 1803(e), if".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to any loan closed on or after October 1, 1989.

SEC. 3. SALE OF VENDEE LOANS.

(a) IN GENERAL.—Paragraph (3) of section 1833(a) of title 38, United States Code, is amended to read as follows:

"(3) The Administrator may sell any note evidencing such a loan with or without recourse, but only if the amount received at the time of such sale is equal to an amount which is not less than 90 percent of the unpaid balance of such loan.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on October 1, 1989.

SEC. 4. COMPUTATION OF ENTITLEMENT AMOUNT.

Section 1802(b) of title 38, United States Code, is amended—

(1) by striking out "or" at the end of clause (1)(B);

(2) by striking out the period at the end of clause (2) and inserting in lieu thereof "; or"; and

(3) by inserting after clause (2) the following new clause:

"(3) the loan has been repaid in full.".

SEC. 5. WAIVER.

Section 3102(b) of title 38, United States Code, is amended by adding at the end the following new sentence: "The Administrator may not make a determination with respect to equity and good conscience solely on the basis of a balancing of fault or on whether the veteran might be able to repay the indebtedness.".

SEC. 6. STUDY, PLAN, AND REPORT ON DISPOSAL OF CERTAIN VETERANS' ADMINISTRATION PROPERTIES.

(a) FINDING.—The Congress finds that the manner in which auctions have been used to dispose of foreclosed real property held by the Veterans' Administration has had some negative effects.

(b) STUDY.—The Administrator of Veterans' Affairs shall carry out a study for the purpose of evaluating the most effective methods of disposing foreclosed properties held by the Veterans' Administration, including auctions, leasing with options to buy, selling through brokered sales, and disposing for the benefit of the homeless. Such evaluation shall be completed no later than 90 days after the date of the enactment of this Act. With regard to auction sales, the evaluation should develop criteria to determine circumstances under which auctions may be the best disposition method.

(c) PLAN AND REPORT.—Based upon such evaluation, the Administrator shall, no later than 120 days after the date of the enactment of this Act, prepare a comprehensive plan for the disposition of foreclosed real property held by the Veterans' Administration and transmit the plan to the Congress.

(d) PENDING ACTION.—Until such plan has been transmitted to the Congress, the Administrator should refrain from disposing of such real property through auctions.

Introduction

On March 17, 1988, the Subcommittee on Housing and Memorial Affairs initiated a series of extensive oversight hearings on the solvency of the VA Home Loan Guaranty Program. Although the most significant housing reform bill since the inception of the Home Loan Guaranty Program was approved by the President on December 21, 1987, the program was faced with impending financial disaster prior to the implementation of the provisions.

Testimony was received from the Veterans Administration; U.S. General Accounting Office; National Association of Home Builders; Mortgage Bankers Association of America; National Association of Realtors; National Council of Savings Institutions; Manufactured Housing Institute; National Manufactured Housing Finance Association; Society of Real Estate Appraisers; Professor Robert H. Edelstein, University of California at Berkeley; The American Legion; Disabled American Veterans; Veterans of Foreign Wars; Non-Commissioned Officers Association; Paralyzed Veterans of America and Vietnam Veterans of America.

The testimony reiterated the positive nature of the VA Home Loan Guaranty Program which has benefited nearly 13 million veteran homeowners since inception. The fact that nearly three-quarters of the outstanding loans have been repaid in full is a tribute to the program's success. Some of the testimony suggested ways in which the Veterans Administration could better manage its operations.

The next hearing on June 16 focused on revenue enhancement initiatives which, in addition to continuing this program as an entitlement, would assure that it operates in a fiscally prudent manner. Testimony was received from the Veterans Administration which was accompanied by the managing director of Kidder, Peabody and Company, Inc.; The First Boston Corporation; Government National Mortgage Association; Non-Commissioned Officers Association; The American Legion; Disabled American Veterans; Veterans of Foreign Wars; Paralyzed Veterans of America; Mortgage Bankers Association of America; National Association of Homebuilders; National Association of Realtors; National Auctioneers Association; Larry Latham Auctioneers; Manufactured Housing Institute and Professor Robert H. Edelstein, University of California at Berkeley.

In addition, informal discussions were held with other federal agencies and ad hoc committees. H.R. 5221 was drafted in response. The Subcommittee recommended the bill to the full Committee on September 7 with an amendment in the nature of a substitute. The full Committee met on September 15, and ordered H.R. 5221, as amended, reported to the House by unanimous voice vote.

Summary of the Bill

The reported bill would:

(1) Require collection of a mortgage indemnity fee for veterans which would offset future losses incurred by the VA in connection with the foreclosure of guaranteed loans.

(2) Require veterans to pay 1¼% fee (could be financed over the life of the loan, but lender must remit to VA upfront), supplemented by a ¼% premium for three years paid by the Government.

(3) Enable veterans who make a 5% or more downpayment to pay a ¾% fee.

(4) Exempt veterans rated 30% or more service-connected disabled from paying fee.

(5) Create the concept of mortgage indemnity, which means that a debt would no longer be established against the veteran should he default on loan.

(6) Discontinue the 1% funding fee currently authorized the effective date of enactment.

(7) Authorize establishment of account to receive collections and other revenue, as well as pay obligations incurred in connection with loans closed after date of enactment.

(8) Authorize investment in Government securities of excess monies.

(9) Retain the Guaranty agreement, so basic operation of program remains intact.

(10) Continue current 1% fee for vendee loans, with purchasers remaining liable.

(11) Continue current ½ of 1% fee for assumed loans, with assumers liable for losses.

(12) Authorize the effective date of Mortgage Indemnity Program 10/1/89.

(13) Authorize the sale of the loan portfolio—with or without recourse, but only if 90 percent or better is received at time of sale. Effective date 10/1/89.

(14) Modify refinancing loan provisions and allow for easier refinancing of conventional loans.

(15) Rewrite section 3102 to make clear that "equity and good conscience may not be decided solely on a balancing of fault nor on speculation that the veteran might be able, at some future date, to repay the debt."

(16) Require the Veterans' Administration to study the most effective methods of disposing of foreclosed properties and develop criteria to determine circumstances under which auctions may be the best disposition method.

Background and Discussion of the Bill

The VA Home Loan Guaranty Program was established under the Servicemen's Readjustment Act of 1944 (P.L. 78-346). As World War II drew to a close, Congress sought ways to ease the economic and sociological readjustment of returning service men and women to civilian life. The program was an innovative means of affording veterans favorable credit which would allow them to purchase a home, business or farm. Many of these veterans, because of their service in the Armed Forces, had missed an opportunity for estab-

lishing personal credit or for accumulating enough money for a substantial downpayment on a home. By utilizing the guaranty of the United States, these veterans were able to enter the homebuying market on a comparable level with their nonveteran counterparts.

Although the objectives of the legislation were specific to the readjustment of returning veterans, rather than influencing the economy as a whole, the VA Home Loan Guaranty Program, as a by-product, created an excellent investment outlet for the large pool of savings that had been built up during World War II. Channeling this investment capital into a productive peacetime activity was perceived as a means of stimulating the economy and averting to some degree the possibility of post-war depression. Under the original program, guaranties could be made up to 50 percent of the loan, not to exceed $4,000. There was a 20-year maximum on repayment terms, and a maximum 4 percent interest rate. The VA may presently guarantee 50% of the loan's value for loans under $45,000 and 40% for loans over $45,000 with a maximum guaranty of $36,000 and a minimum guaranty of $22,500.

Over the years, Congress enacted many other changes to the program to enhance its viability, and to respond to developments in the economy and to changes in the needs of veterans. There is now no delimiting date for a veteran to make use of this benefit, and entitlement may be regained once the veteran has paid off the initial loan in full and disposed of the property.

Since the inception of the VA Home Loan Guaranty Program in 1944, almost 13 million veterans have received VA-backed mortgage assistance. More than three-quarters of these loans have been repaid. The program has been enormously successful in terms of helping veterans to become home owners and has proved to be a powerful stimulus to the nation's economy.

Despite the program's obvious success, actions by the Office of Management and Budget designed to ease the federal government out of housing programs have tended to weaken the program's potential for serving veterans effectively, and to threaten the long-term solvency of the Loan Guaranty Revolving Fund.

HISTORICAL DATA ON THE FINANCIAL CONDITION OF THE LOAN GUARANTY REVOLVING FUND

From 1944 to 1961, the Loan Guaranty Revolving Fund was funded by the Readjustment Benefits Appropriation Account. All program costs due to foreclosure of GI loans were paid from that account, which received annual appropriations. Collections generated from the sale of acquired properties were returned to the U.S. Treasury. No attempt was made to make the program self-sustaining. It was understood that expenses would exceed collections and that appropriations would be necessary to support the program. Each year from 1947 through 1961, appropriations were made to the Readjustment Benefits Account to fund program expenses.

In 1961, the Loan Guaranty Revolving Fund (LGRF) was created. The purpose of the revolving fund was to put the program financ-

ing on a more business-like basis. Operationally, the program would be no different. However, receipts from the program operations would be deposited into the fund and be available immediately for ongoing expenditures. The revolving fund would allow for improved budgetary and accounting control as well. In establishing the Loan Guaranty Revolving Fund, Congress authorized transfers from the Direct Loan Revolving Fund (DLRF) as needed to offset shortfalls previously funded by appropriations.

The Direct Loan Revolving Fund was established in 1950 to make direct loans to veterans living in rural areas who could not obtain guaranteed loan financing. Principal and interest collections on direct loans far exceeded new lending requirements, and provided a source of funds for the guaranteed loan program in lieu of direct appropriations. The concept was that one veterans' housing program (direct loans) could help support the other (guaranteed loans) without appropriations from the Congress.

During the first six fiscal years of the revolving fund's existence (1962 through 1967), $633.9 million was transferred to the LGRF. In the 23 years since the inception of the program (1945–1967) appropriations or transfers from the Direct Loan Revolving Fund were necessary in all but two years.

However, for the next 10 fiscal years (1968–1977) the revolving fund operated without transfers from the Direct Loan Revolving Fund or appropriations. During this period there were 4 fiscal years in which collections to the fund exceeded expenditures. This change in the historical pattern of costs and collections gave the impression to many observers that the Loan Guaranty Revolving Fund was self-sustaining. In fact, the revolving fund performance reflected overall economic conditions. The economy was relatively stable; the GI mortgage interest rate maximum was in the 7–9 percent range; foreclosure rates and unemployment were low; and real estate values were appreciating sharply. Many veterans who did face financial difficulty during this period were able to dispose of their properties and satisfy their indebtedness without losses being incurred by VA. As an example, during the 1970's, annual home price appreciation averaged 10.9 percent. This allowed thousands of veterans to escape foreclosures which would undoubtedly occur in many regional markets today.

It should be noted that VA's experience with foreclosures was not unique. The Federal Housing Administration (FHA) (203B) program had a very similar foreclosure trend as did conventional mortgage loans.

The financial condition of the LGRF began changing in the late 70's. In FY 1978, $100 million was transferred from the DLRF as expenditures exceeded receipts by $80 million. Mortgage interest rates rose sharply in 1980 in response to changes in Federal Reserve policy. In 1980, the average GI interest rate was almost 12%. Of all loans guaranteed that year 11.6% have gone to foreclosure compared with 3.5% for 1977 loans.

GI home loan interest rates peaked at 17½% in 1982. This was coupled with a severe recession period, characterized by high un-

employment, factory closings, and personal bankruptcies. Particularly hard hit at the time were the industrialized Great Lakes region and upper midwest. The decline in automobile production brought on by recession, high interest rates and growing foreign competition severely affected steel, rubber and glass industries. The farming states were also hard hit by recession. The effect of these factors is reflected in the increase in VA's inventory of foreclosed properties. At the end of FY 1980, there were 9,023 properties in VA's inventory compared with 17,269 two years later.

As the midwestern part of the country coped with recession, the southwestern part of the U.S. began to experience a boom in response to oil prices. The price of domestic oil at the well head rose from $9 a barrel in 1978 to $31.77 in 1981. Investors speculated that prices would go even higher. Unemployment rates in Texas, Oklahoma, and Colorado were well below the national average. Oil prices didn't go higher but remained strong ($24-28 per barrel) in 1982-85. Prices were drastically reduced (approximately $12.51) in 1986 and this led to a severe recession in the energy industry causing high unemployment, property depreciation, and heavy GI loan foreclosures. In Texas alone business and personal bankruptcies totaled 37,170 for the twelve month period ending June 30, 1987, compared with 9,589 in June 1981.

It should be noted that with the exception of necessary appropriations to establish the Loan Guaranty Revolving Fund in 1961 no appropriations have been required until the end of fiscal year 1983. Since that time, nearly $1.7 billion in external financing has been needed. The Direct Loan Revolving Fund is depleted and cannot provide support.

Nearly $1 billion was needed to fund the Loan Guaranty Revolving Fund in fiscal year 1988 alone. The fiscal year 1988 supplemental and shortfall was due to the Veterans Administration's inaccurate projection of foreclosures—the Veterans Administration originally estimated 30,746 foreclosures but now re-estimates 51,400. The additional money was necessary to pay losses incurred by the federal government as a result of these foreclosures.

MORTGAGE INDEMNITY FEE

Over the last several years, the Administration has submitted legislative proposals to the Congress to increase the 1% funding fee. The proposals would have increased the funding fee in FY 1986 from 1 to 5%; 1 to 3.8% on a graduated scale in FY 1987; and 1 to 2.5% in FY 1988. When the Congress enacted the 1 percent origination fee, the fee bore a responsible relationship to the administrative costs of servicing loans. The Administration proposals to increase the fee had no bearing on a veteran's loan but rather were loosely based on a given year's expenditures in regard to the foreclosure rate on older loans.

Approximately 48,800 foreclosures are projected for fiscal year 1989 with an anticipated $658 million appropriation request in revenues to fund the program and similar scenaries are predicted in subsequent fiscal years. Because of the Committee's concern, it held several hearings on the solvency of the program. The hearings

focused on potential solutions which would keep the entitlement nature of the program intact as well as create a more prudent funding mechanism.

The Committee bill therefore would set up a 1¼% mortgage indemnity fee for veterans supplemented by a ¼% premium for three years by the Government. Service-connected disabled veterans rated 30% or more and service-connected widows would be precluded from paying this fee. Veterans who make a downpayment of 5% or more would be charged a ¾% fee. This new fee would provide indemnity for veterans in that they would no longer be liable to the Veterans Administration for outstanding debts in the event of foreclosure. The Committee notes that FHA seldom pursues individuals whose loans have gone into foreclosure and mortgage bankers seldom establish deficiency judgments against homeowners with conventional loans.

The Committee bill would establish a new account to receive these collections as well as pay obligations incurred in connection with loans closed after date of enactment, and gives the Veterans Administration the authority to invest excess monies in government securities. FHA currently has the authority to invest their excess monies. According to the Congressional Budget Office, the VA could possibly collect $218.3 million in interest over the next 10 years.

The Committee bill will not affect the current entitlement features of no-downpayment loans up to $144,000 and the VA will continue to set interest rates, which historically have been somewhat less than conventional rates. In addition, the nature of the guaranty to the lending community is not being changed.

According to the Congressional Budget Office, the Committee bill will put the program on a sound financial footing. The Committee hopes that this long-range plan will deter any efforts to undermine this program including "back door" approaches to terminating this program. In addition, the Committee notes that many of the VA's recent administrative decisions have been based on the impact on outlays from the Loan Guaranty Revolving Fund in one fiscal year, rather than a concern for long term prudent management. The Committee believes that this measure will have a beneficial impact on the future solvency of the VA Home Loan Guaranty Program.

The bill's fee structure was based upon FHA's experience in formulating its mortgage insurance structure. FHA computer models were used to calculate a one-time fee based on VA's past and projected foreclosure statistics. Projections were formulated to calculate the present value of expected income equal to the sum of projected expenses associated with these new loans.

The new "fee" structure, according to FHA, should be at slightly under 2% for the VA mortgage program based on the following assumptions:

(1) The term of the loan is 30 years;.
(2) the contract interest rate is 10% compounded monthly;
(3) the discount rate is 6.5% compounded semi-annually;

(4) the loss ratio is 30% of the original mortgage amount; and

(5) the ultimate claim rate is 8.03% and claims occur as in Table 1. Moreover, the claim rates of Table 1 are calculated by taking a weighted average of VA's actual experience through the end of fiscal year 1987 as shown in Table 2. Each loan received equal weight in the averaging process.

TABLE 1

CLAIM RATES BY POLICY YEAR

Policy year	*Claim Rate*
1	.02%
2	.56
3	.1.45
4	.1.44
5	.1.15
6	.80
7	.59
8	.45
9	.29
10	.20
11	.14
12	.11
13	.09
14	.08
15	.05
16	.04

Note: For policy years 17–30, 0.04% was used—the claim rate for the 16th policy year.

Table 2

Claims Based on Loan Date vs. Termination Date—Includes Manufactured Home Loans Through September 30, 1987

Fiscal year Terminated	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972
1987	677	4,425	7,708	8,384	3,415	4,053	4,385	3,220	1,760	992	577	375	320	193	150
1986	4	904	5,073	7,296	4,083	4,642	4,150	2,989	1,541	873	535	337	305	236	155
1985		14	1,269	5,198	4,704	6,087	4,772	3,280	1,676	941	565	373	338	232	222
1984			17	1,139	4,444	6,988	5,581	3,625	1,712	1,059	607	462	391	295	217
1983				10	1,391	5,850	5,579	3,643	1,802	1,073	678	496	416	303	262
1982					34	1,768	4,815	3,535	1,922	1,095	735	563	437	294	293
1981						36	2,129	3,661	2,215	1,363	885	657	550	411	313
1980							44	1,430	2,743	2,205	1,619	1,139	941	693	517
1979								26	1,279	2,723	3,106	3,146	2,797	1,388	1,027
1978									34	1,297	3,052	2,428	2,142	1,233	847
1977										36	1,615	3,471	3,465	1,967	1,236
1976											59	2,179	4,957	2,980	1,989
1975												102	3,136	4,150	2,958
1974													115	2,474	4,232
1973														82	2,483
1972															93
Partial Claims* (Still Active)	1	6	24	45	18	74	112	153	155	101	26	15	1	0	0
Total Liquidated	682	5,349	14,091	22,072	18,089	29,498	31,567	25,562	16,839	13,758	14,059	15,743	20,311	16,931	16,994

*partial claims contain no termination date

Note: FY 1979 terminations include some loans terminated in previous years. Those not previously recorded were entered when the LOS/GIL linkage was established.

Under the Committee bill, veterans who now must pay a 1% funding fee would be charged 1¼%. However, they would be purchasing indemnity for this additional fee. In other words, they would no longer be liable to the Veterans Administration should their loans terminate in foreclosure. Service-connected disabled veterans rated 30 percent or more would be exempt from paying this fee. Veterans making downpayments of 5 percent or more would only have to pay a ¾% fee.

Since this program was designed as an entitlement, the Veterans Administration would supplement the remainder of the 2% fee over the next three years. The Committee believes that by virtue of this restructuring, the VA will be in a position to cope much more effectively with the program's basic operation.

The bill establishes a new account for the collection of this mortgage indemnity fee and other revenue as well as to pay obligations incurred in connection with loans closed after date of enactment. Excess moneys in the Mortgage Indemnity Fund would be invested in Government securities as is currently done by FHA. This investment feature alone is projected to result in collections of $218 million over the next 10 years.

Since all of the other entitlement features of the VA Home Loan Guaranty Program would remain the same, the basic guaranty agreement would still be in effect.

This provision would become effective on October 1, 1989, in conjuction with the expiration of the 1% funding fee. The postponement of the effective date by one year reduces budget authority from $182 million in FY 1989 to $37 million in FY 1980. It should be noted, however, that this measure saves $3.4 billion over the next 10 years.

LOAN PORTFOLIO SALES

Because of the high foreclosure rate over the past several years, and in conformance with Administration efforts to reduce short-term outlays, the VA has been pressured by the Office of Management and Budget to sell its loan portfolio. In its fiscal year 1988 budget, the Administration proposed yet another revision to its loan sales procedures which would impair the long-term solvency of the Loan Guaranty Revolving Fund. This proposal required the VA to sell all of its loans without recourse (repurchase agreements).

The General Accounting Office (GAO) has issued three reports on the subject of loan asset sales. These reports and testimony before the subcommittee have pointed out that OMB's guidelines would have an adverse effect on the federal government's ability to both market loans and to maximize net sales proceeds. In addition, GAO concluded that loan asset sales are not an effective technique for resolving our fundamental deficit problems.

The General Accounting Office's study, dated February 1988, confirmed these conclusions and stated that loan asset sales will increase, over the long term, the structural federal budget deficit. In addition, the General Accounting Office states that loan asset sales do not effectively measure subsidy costs and that the Administra-

tion's plan to define the subsidy cost of federal credit programs as the monetary benefit—interest cost savings—to a borrower will overstate both government cash costs and the related cost to operate credit programs. Public Law 100-136 effectively prohibited the Veterans' Administration from selling any of its assets unless they could be sold for par. But, this law was repealed until fiscal year 1990, as part of the Economic Summit Agreement, in Public Law 100-203, the Omnibus Budget Reconciliation Act of 1987.

In July, the Veterans Administration held its first non-recourse loan sale. This particular sale involved a two-pool approach—one pool of senior certificates valued at $203.8 million, backed by a subordinate pool worth $105.1 million. The objective of the subordinate pool was to cover any losses due to delinquencies or foreclosures of the senior certificates. The net proceeds of this sale amounted to only $173 million—a 56 percent return on the day of sale. This compares very unfavorably with previous recourse loan sale proceeds where traditionally the VA has received par or better. For example, the February 1988 recourse sale netted above par results with a 1% premium—in other words $1.01 for face value.

At a time when this program is experiencing severe financial difficulty and the Congress has had to appropriate nearly $1 billion in fiscal year 1988, this type of sale makes no sense at all, especially since the Veterans Administration has retained all of the inherent risk as in previous recourse loan sales while receiving considerably less in up-front money.

In addition to the substantial subordination, the VA also was required to secure certificate insurance to obtain higher ratings from rating agencies. Coupled with other related sales costs (i.e., financial advisor, legal representation, underwriting fees, etc.) up front proceeds were further diminished by approximately $8 million.

The Committee believes that if loan asset sales are to continue, sales should be done in such a way as to maximize upfront proceeds to the program. If reasonable prices cannot be expected, income-producing assets should be held for program funding. Until such time as the Veterans Administraton's loan portfolio is sold, the Veterans Administration receives monthly principal and interest from the individuals who have purchased foreclosed properties through vendee financing from the Veterans Administration.

Therefore, the Committee bill gives the Administrator the authority to sell any note evidencing such a loan with or without recourse, but only if the amount received at time of such sale is equal to not less than 90% of the unpaid balance of such loan. The effective date of this provision is October 1, 1989 so as not to violate the Economic Summit Agreement, in Public Law 100-203.

MODIFICATION OF REFINANCING LOAN PROVISIONS

Under current law and implementing regulations, certain veterans may meet the requirements for having loan guaranty entitlement restored. A veteran may qualify for restoration if VA has been relieved of liability on the GI loan, which normally is accomplished by the loan being paid in full, and if the property has been

88-434 0 - 88 - 2

disposed of; or if a veteran-buyer agrees to substitute his or her entitlement for that of the original veteran-borrower and meets all other requirements for substitution of entitlement.

In terms of refinancing, however, it has come to the Committee's attention that once a veteran has refinanced his loan conventionally, he may no longer refinance that same home through a VA guaranty, even though this remains his primary residence. On the other hand, had he originally bought his home with a conventional loan, he would be eligible for VA refinancing. This seemed inconsistent with the beneficial intent of the law, and H.R. 5221 would remedy this inequity.

WAIVER

Under current law, loan guaranty indebtedness may be waived by the Veterans Administration whenever the collection of the indebtedness would be against equity and good conscience. In implementing this provision, VA has traditionally considered two factors: balancing of fault; and veterans' ability to repay. Cases brought to the Committee's attention indicate a shift in focus from the equitable consideration intended by law to a much stricter loan forgiveness posture.

For example, waiver is being denied to unemployed destitute veterans because VA speculated that some day the veteran might get a job which might enable him to repay the debt.

H.R. 5221 would refocus VA's attention on the current law's beneficial and equitable intent.

DISPOSAL AND USE OF CERTAIN VETERANS' ADMINISTRATION PROPERTIES

The Committee believes that the Veterans Administration should only pursue constructive and effective property disposition programs so that it can maximize to the fullest extent possible returns from the sale of its assets.

It is acknowledged by the Committee that some properties may, for many different reasons, not be marketable within a reasonable time, and that there may be cases where auctions may be warranted. However, when the Administration announced a decision to hold auctions every weekend for three months, the Committee became highly concerned with the manner in which auctions were being used as a marketing tool. This policy was being utilized strictly to generate immediate cash receipts for the Loan Guaranty Revolving Fund without any thought to potential long-term adverse implications. When the Committee learned that regional offices were receiving reasonable offers from prospective purchasers for properties but were turning them down and taking the properties off the market for auction purposes, it urged the Veterans Administration to look at other alternatives.

Section 6 of this bill, therefore requires the Veterans Administration to study the most effective methods of disposing of foreclosed properties including auctions, leasing with options to buy, selling through brokered sales and disposing for the benefit of the home-

less. This evaluation should be completed no later than 90 days following the date of enactment and should include criteria to determine circumstances under which auctions may be the best disposition method.

Based upon this evaluation, the Administrator is required to transmit to the Congress within 120 days of enactment a comprehensive plan for the disposition of foreclosed real property. Prior to such transmittal, the Veterans Administration should refrain from disposing of such real property through auctions.

Section by Section Analysis

Section 1.—Short Title, this bill is entitled the "Veterans Home Loan Mortgage Indemnity Act of 1988."

Section 2.—Establishment of Special Indemnity Fund and Loan Fee.

Subsection (a) would add a new section 1824A to title 38, United States Code. Subsection (a) of the new section 1824A would establish a new revolving fund known as the Veterans' Administration Mortgage Indemnity Fund (MIF).

Subsection (b) of the new section 1824A provides that the MIF would pay for all housing loan operations, other than administrative expenses, with respect to loans originally guaranteed or insured after the effective date of this section (hereafter "new loans") for which veterans paid the loan fee required under 38 U.S.C. §1829.

Subsection (c) of the new section 1824A provides that revenues from the loan fee on new loans would be deposited into the MIF. In addition, there would be credited to the MIF an amount equal to one-quarter of 1 percent of the original loan amount of each new loan for which a veteran pays the fee. This credit would be made each year for 3 fiscal years beginning in the year a loan was guaranteed. All amounts collected by VA with respect to new loans; e.g., the proceeds from the sale of property foreclosure, would also be deposited in the MIF. In addition, interest earned pursuant to subsection (d) of this new section would be deposited into the MIF.

Subsection (d) of the new section 1824A would require the Secretary of the Treasury to invest the balance of the MIF not required to meet current expenses in interest bearing obligations of or guaranteed by the United States.

Subsection (b) would make the following amendments to 38 U.S.C. §1829 relating to the loan fee. The fee for new guaranteed loans would be increased from the present 1 percent to 1.25 percent of the loan amount. If, however, the veteran obtains a loan to purchase or construct a dwelling and makes a 5 percent down payment, the fee would be decreased to ¾ of 1 percent. The exemption from paying the fee currently granted to disabled veterans eligible for compensation would be restricted to veterans rated 30 percent or more disabled. The September 30, 1989, sunset for the fee on new guaranteed loans would be repealed. (The fees currently charged vendee loan borrowers and persons assuming existing

loans pursuant to 38 U.S.C. §1814, and the sunset for such fees, would remain unchanged.)

Subsection (c) would exempt veterans who pay the fee on new guaranteed loans from liability to VA following foreclosure.

Subsection (d) would make conforming amendments to 38 U.S.C. §1824 (relating to the existing Loan Guaranty Revolving Fund) and certain other provisions.

Subsection (e) would make the amendments made by this section applicable to loans closed on or after October 1, 1990.

Section 3.—Sale of Vendee Loans

Subsection (a) would allow VA to sell vendee loans either with or without recourse, but only if the amount received at the time of sale is equal to at least 90 percent of the unpaid balance on the loans.

Subsection (b) would make this amendment effective October 1, 1989.

Section 4.—Computation of Entitlement Amount. This section would permit VA to restore a veteran's previously used Loan Guaranty entitlement if the prior loan has been paid in full.

Section 5.—Waiver. This section would provide that in considering requests for waiving housing loan debts, pursuant to 38 U.S.C. §3102(b), the VA will not consider solely a balancing of fault or whether the veteran might be able to repay the debt.

Section 6.—Study, Plan and Report on Disposal of certain Veterans' Administration Properties

Subsection (a) would make a finding that the manner in which VA has used auctions to dispose of acquired properties has had some negative effects.

Subsection (b) would require VA to evaluate the most effective methods for disposing of foreclosed properties. This evaluation must be completed within 90 days after enactment.

Subsection (c) would require VA to develop a comprehensive plan for disposing of properties based on the evaluation required by subsection (b) and to transmit that plan to the Congress within 120 days after enactment.

Subsection (d) expresses the Sense of Congress that VA should refrain from disposing of properties through auctions until it transmits the plan to the Congress pursuant to subsection (c).

Oversight Findings

No oversight findings have been submitted to the Committee by the Committee on Government Operations.

CBO Cost Estimate

The Committee received the following letter from the Congressional Budget Office on the reported bill:

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

September 16, 1988

Honorable G. V. Montgomery
Chairman
Committee on Veterans' Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The Congressional Budget Office has reviewed H.R. 5221, the Veterans' Home Loan Mortgage Indemnity Act of 1988, as ordered reported by the House Committee on Veterans' Affairs, September 15, 1988.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

James L. Blum
Acting Director

cc: Honorable Gerald B. H. Solomon
Ranking Minority Member

CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 16, 1989

1. BILL NUMBER: H.R. 5221

2. BILL TITLE:

Veterans' Home Loan Mortgage Indemnity Act of 1988.

3. BILL STATUS:

As ordered reported by the House Committee on Veterans' Affairs, September 15, 1988.

4. BILL PURPOSE:

This bill would replace the existing home loan guaranty program with a new home loan insurance program for veterans. The new program is designed to be actuarially sound, based on estimates by the Department of Housing and Urban Development of the federal liability on VA loans. Under the new program, the origination fee paid by VA borrowers would be 1.25 percent of the mortgage principal (The current fee of 1.0 percent will expire at the end of fiscal year 1989 under current law.), except in the case of individuals who make downpayments of 5 percent or more. The fee for the latter category would be 0.75 percent.

Under the new program, the government would also contribute its share of the anticipated future default costs of the loans at the time of origination. Government contributions of 0.75 percent of the mortgage principal would be made to the loan fund for each loan insured. The government contribution for a loan, however, would be spread over three years, with 0.25 percent paid in each of the first three years after origination.

Also, veterans obtaining mortgages under the new program would not be held liable for any debt related to the mortgage that is not satisfied by the sale of the securing property after foreclosure.

Finally, the bill would permit the VA to sell vendee loans with or without recourse, as long as the agency receives total proceeds at the time of sale of at least 90 percent of the value of the loans sold. Under current law, the VA would be required to sell loans with recourse after fiscal year 1989.

The provisions of H.R.5221 would be effective on October 1, 1989.

5. ESTIMATED COST TO THE FEDERAL GOVERNMENT:

	(By fiscal years, in millions of dollars) 1989	1990	1991	1992	1993
Loan Guaranty Revolving Fund					
Budget Authority	0	-11	-133	-477	-775
Estimated Outlays	0	-10	-118	-410	-638
Mortgage Indemnity Fund					
Budget Authority	0	48	110	213	287
Estimated Outlays	0	-198	-143	123	337
Function 900 Offset					
Budget Authority	0	*	17	31	32
Estimated Outlays	0	*	17	31	32
Net Budget Impact					
Budget Authority	0	37	-6	-233	-456
Estimated Outlays	0	-208	-244	-256	-269

The cost of this bill would fall in budget functions 700 and 900.

Basis of Estimate

This estimate was prepared from a model that interrelates the various obligation and collection activities of the Loan Guaranty Revolving Fund (LGRF) based on historical relationships and projects these factors using past trends and expectations of future economic activity.

Even though H.R. 5221 would abolish the current veterans' home loan guaranty program and would replace it with a mortgage indemnity program, the affect of the bill on program operations would be relatively minor. H.R. 5221 is primarily a financing measure, designed to ensure that sufficient capital is placed in the revolving fund at the time new loans are insured to cover the anticipated cost of defaults of those loans.

The outlays of the LGRF would be expected to fall substantially under this bill, because the default costs of loans insured after 1989 would be paid from the Mortgage Indemnity Fund (MIF). The MIF would experience negative net outlays in 1990 and 1991, while the default costs of new loans are less than the amount of fees collected from those loans. After 1991, MIF default costs are expected to exceed offsetting collections and to result in positive net outlays.

This does not mean, however, that the MIF would operate at a deficit during this period. The MIF should continue to carry a significant unobligated balance through 1993 as a result of federal contributions and proceeds from loan sales. These two forms of financing would increase the balances of the fund that are available for obligation, but they would not offset outlays.

Virtually all of the savings attributable to this bill result from the extension of the VA's authority to charge origination fees and from the increase of 0.25 percent in the fee charged to most borrowers. The authority to charge origination fees would expire at the end of fiscal year 1989 under current law.

According to VA data, approximately 72 percent of the individuals obtaining VA-guaranteed loans make downpayments of less than 5 percent. Under H.R. 5221 these borrowers would have to pay an origination fee of 1.25 percent, rather than the current 1.0 percent of the mortgage amount. Veterans making downpayments of 5 percent or more would pay a fee of only 0.75 percent. It is not expected that either of these fee changes would be large enough to significantly affect the number of individuals obtaining VA loans.

The elimination of the continuing liability of defaulting borrowers for any debt remaining after the sale of the securing property should have only a small impact on the revolving fund, because the VA collects only about 7 percent of such debt now. It is not expected that this release from liability would significantly increase the default rate, since few conventional lenders make serious attempts to collect such debts, and conventional foreclosure rates are lower than VA's.

Additional Function 700 outlay savings are generated by the authority of the Mortgage Indemnity Fund (MIF) to invest the unobligated balances of the fund in Treasury securities. Interest collections of the fund are estimated at nearly $80 million between 1990 and 1994. While these collections would reduce outlays from the MIF, there would be a corresponding increase in outlays from the Treasury. Thus, there would be no net effect on total federal spending from this provision.

Section 3 of H.R. 5221 would permit the VA to sell vendee loans only under conditions wherein they would receive a 90 percent or better return at the time of sale. This estimate assumes that the VA would only be able to achieve this rate of return by selling loans with full recourse to the government for defaults. Under current law, the VA would already be required to sell loans with recourse after 1989, and this is reflected in the CBO baseline. Therefore, this provision would have no impact.

6. ESTIMATED COST TO STATE AND LOCAL GOVERNMENTS:

The Congressional Budget Office has determined that the budgets of state and local governments would not be significantly affected by enactment of this bill.

7. ESTIMATE COMPARISON: None.

8. PREVIOUS CBO ESTIMATE: None.

9. ESTIMATE PREPARED BY: K.W. Shepherd (226-2820).

10. ESTIMATE APPROVED BY:

James L. Blum
Assistant Director
for Budget Analysis

INFLATIONARY IMPACT STATEMENT

The reported bill would have no inflationary impact.

AGENCY REPORTS

The Committee received the following letter from the Veterans' Administration concerning the reported bill:

Office of the
Administrator
of Veterans Affairs

Washington DC 20420

Veterans
Administration

SEP 9 1988

Honorable G. V. (Sonny) Montgomery
Chairman, Committee on
Veterans' Affairs
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This will respond to your request for the views of the Veterans Administration on H.R. 5221, 100th Congress, the "Veterans' Home Loan Mortgage Indemnity Act of 1988."

The Administration strongly opposes several sections of this bill. We believe the remainder of the measure requires further study and technical refinement.

Section 2(a) of H.R. 5221 would establish a new revolving fund known as the Veterans' Administration Mortgage Indemnity Fund (MIF). The MIF would pay for all housing loan operations, other than administrative expenses, with respect to loans originally guaranteed or insured after the effective date of this section for which veterans paid the loan fee required under 38 U.S.C. § 1829.

The existing Loan Guaranty Revolving Fund (LGRF) would continue to cover expenses related to loans made prior to the effective date. The LGRF would also cover loans assumed under 38 U.S.C. § 1814 which were originally guaranteed before the effective date. In addition, it appears that the LGRF would cover expenses related to guaranteed loans obtained by disabled veterans and surviving spouses who are exempt from paying the loan fee.

Revenues from the loan fee collected under 38 U.S.C. § 1829 on new loans would be deposited into the new MIF. In addition, there would be credited to the MIF an amount equal to 1/4 of 1 percent of the original loan amount of each loan guaranteed after the effective date of the bill for which a veteran pays the fee. This credit would be made each year for 3 fiscal years beginning in the year a loan was guaranteed. Apparently, no Government contribution would be made for loans to disabled veterans and surviving spouses who are exempt from paying the fee.

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Since H.R. 5221 does not specify a funding source, it would appear that it would create permanent budget authority; i.e., a permanent mandatory stream of Federal obligations not subject to the annual appropriations process. In the alternative, the requirement for a Government contribution may establish a loan guaranty ceiling. In the absence of sufficient appropriations, VA may be unable to guarantee new loans unless sufficient funds were available to make the current year's contribution.

Any amounts collected by VA with respect to such new loans; e.g., the proceeds from the sale of the property, following foreclosure, would also be deposited in the MIF.

The Secretary of the Treasury would be required to invest the balance of the new MIF not required to meet current expenses in interest bearing obligations of or guaranteed by the United States. Interest earned on such funds would also be deposited into the MIF.

Collections relating to loans made prior to the effective date of the bill, and fees from section 1814 assumptions of such loans, would continue to be deposited into the existing LGRF.

This bill would significantly alter the funding of the VA housing loan programs. It would commit the Government to a 3/4-point subsidy of each loan over the existing benefit level. In addition, it would further complicate the management of the program between two funds with significantly different funding mechanisms.

VA is well aware that in recent years the costs to the taxpayers of operating this important benefit to veterans has been significant. We share your concern about the future solvency of the Loan Guaranty Program. However, we believe certain sections of H.R. 5221 would be detrimental to the program. Specifically, we oppose the concept of no future liability for veterans who pay the new fee, and the 90 percent of par minimum for loan sales. Issues that we believe need further study include: the use of permanent budget authority to pay a Government contribution and the assumption that it would be sufficient to preserve the liquidity of the fund, and the ability of the existing Revolving Fund to pay the costs associated with loans already guaranteed.

Creation of new permanent budget authority by requiring a Government matching contribution to the MIF may run counter to

3.

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Public Law 93-344, the Budget and Impoundment Control Act of 1974. Further, we believe this concept should be considered in the larger scope of the Administration's credit reform proposal which would provide appropriations for subsidy amounts.

It is very likely that the MIF will not have sufficient balances in the first several years to maintain fund operations. Further, without deposit of future funding fees in the existing LGRF, it will not be possible to meet the obligations arising out of loans already guaranteed without increased appropriations.

Our concern for the future solvency of the Loan Guaranty Program led us to contract with Peat, Marwick, Main & Co. to conduct a feasibility study of various mortgage insurance options as a cost-effective means of providing the veteran housing benefit. Topics to be explored include the design of a viable mortgage insurance program which maintains its status as a veteran's benefit, the premiums which would have to be charged, who would pay them, the size of a reserve which would be necessary, and the total costs of the program, etc. This will involve development of an outline of at least three different approaches to a mortgage insurance program for veterans.

Upon our approval, the contractor will then develop in detail the option chosen by us, including the mentioned items and the effect that implementation of such a program would have on the existing obligations of the Revolving Fund. The study should be completed before the end of this year. We would like to consider H.R. 5221 further in conjunction with this study.

Section 2(b) of the bill would make several amendments to section 1829 of title 38, United States Code, relating to the loan fee. The bill would generally increase the fee from the present 1 percent to 1.25 percent of the loan amount for a veteran obtaining a guaranteed loan after the effective date. If, however, the veteran obtains a loan to purchase or construct a dwelling and makes a 5 percent down payment, the fee would be decreased to 3/4 of 1 percent of the loan amount.

The fee for vendee loans would remain at 1 percent, and the fee from persons assuming existing loans pursuant to section 1814 of title 38 would remain at 1/2 of 1 percent. This amendment would remove the sunset for the fee on new guaranteed loans, but would retain the September 30, 1989, sunset for the fee on vendee loans and section 1814 loan assumptions.

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VA is currently working with Booz Allen Hamilton to develop a forecasting model for the Loan Guaranty Program. We anticipate that the contractor's work will be completed in November 1988.

After we have had the opportunity to evaluate their work, as well as the results of the Peat, Marwick, Main report, we previously described, we would be in a better position to comment on the adequacy of the fees proposed in H.R. 5221.

Under current law, all veterans eligible for compensation for service-connected disabilities are exempt from paying the fee. H.R. 5221 would limit this exemption to veterans whose disability is rated 30 percent or greater. There are currently approximately 2.2 million veterans on VA's disability compensation rolls. Of these, approximately 1.2 million are rated as less than 30 percent disabled. Although VA supports exempting disabled veterans from paying the loan fee, we would have no objection if the Congress established a threshold for qualifying for this exemption.

The exemption from the loan fee given to surviving spouses under the present law would remain unchanged.

Section 2(c) of the bill would provide that veterans paying the fee on guaranteed loans after the effective date would not have any liability to the Government for a loss following default and foreclosure of the loan.

VA strongly opposes this provision.

We believe that veterans, like all Federal borrowers, should be responsible for the debt created through foreclosure, and we also believe that the lack of such a responsibility may take away the incentive to pay on a loan from those who could otherwise do so. The liability provisions of the current program provide a strong incentive for veterans to maintain their loan obligations and to cooperate with loan holders and VA in exploring alternatives to foreclosure.

Many veterans who have become delinquent make a considerable effort to work out the default through repayment plans which enable them to bring their accounts up-to-date and save their homes. Others work with VA in pursuing alternatives to foreclosure, such as tender of a deed in lieu of foreclosure or private sale of the property. Adoption of the proposal would remove this incentive. This could result in an increase in foreclosures, an increase in VA's average loss per foreclosure, and a corresponding increase in appropriations.

5.

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We further note that the exemption from liability applies only to veterans who pay the new fee. Since certain disabled veterans and surviving spouses are exempt from the fee, these most deserving beneficiaries would, alone, remain liable to the Government following a foreclosure. If, notwithstanding our objection, the Congress should decide to eliminate loan guaranty indemnity debts, this exemption should also cover those who, by law, are exempt from paying the fee.

The release of liability under section 2(c) of the bill apparently was not intended to apply to vendee loans or loans assumed under 38 U.S.C. § 1814. We are not certain of the intended affect of the bill's reference to section 1814 assumptions. Under that section of title 38, an eligible transferee merely assumes the veteran's liabilities. Since the veteran would have no underlying liability to the Government, there would appear to be no such liability for a transferee to assume.

Section 2(d) of the bill makes conforming amendments.

Section 2(e) of the bill provides that all amendments made by section 2 of H.R. 5221 will take effect on the first day of the second month beginning after the bill's enactment.

Section 3 of H.R. 5221 permits VA to sell vendee loans either with or without recourse, but only if the amount received at the time of sale is equal to at least 90 percent of the unpaid balance on the loans.

VA strongly opposes this section.

Under current law, when VA sells vendee loans, complex projections must be made of the anticipated yields and costs of recourse and nonrecourse sales of each block of loans to be offered for sale. Based upon such projections, a determination is made as to whether or not it is in the best interests of the effective functioning of the Loan Guaranty Program to sell with or without recourse. After October 1, 1989, VA would be prohibited from selling loans without recourse unless they could be sold at par.

For all practical purposes, by requiring that loans be sold for at least 90 percent of par, H.R. 5221 would prohibit loans from being sold without recourse. The Administration's credit management policy favors selling loan assets without recourse. This is because selling with recourse runs counter to effective

debt management, provides no incentives for improving loan origination and portfolio management, and does not provide an accurate measurement of the subsidy inherent in extending Federal credit assistance. In addition, selling the loans with recourse creates a contingent liability to the Government for the full face value of the loan. This contingent liability represents the possible full extent of the Government's cost for repurchasing vendee loans that eventually default. Moreover, this represents an expensive means for borrowing funds.

Present law imposes complex and costly administrative requirements on VA without tangible benefit. The effective prohibition of nonrecourse sales through a requirement to sell at par, or the proposed 90 percent of par, is an unnecessary and unwarranted interference with the administrative flexibility required by VA to dispose of loan assets. Instead, we believe that the law should be amended to grant the VA flexibility to sell loans in a cost-effective manner, either with or without recourse, without the administrative burdens now contained in law or proposed in H.R. 5221.

Section 4 of the bill revises the computation of available entitlement after prior use of the Loan Guaranty benefit. As drafted, this section would effectively eliminate the requirement that for restoration of entitlement the property securing a VA loan be disposed of by the veteran. Only the requirement that the loan be paid in full (or assumed by a veteran transferee) would remain.

In the past we have opposed such a change since our main goal is to assist veterans in obtaining their primary home. To allow restoration of entitlement based simply on repayment of the loan could allow the VA loan guaranty to be used for investment purposes. It is conceivable that a veteran could purchase several homes, keeping some for investment purposes, with VA guaranteed loans.

From informal discussions with your staff, we understand this amendment is intended to assist veterans obtain interest rate reduction refinancing loans. You desire to help veterans who have purchased homes with a VA loan, refinanced it with an FHA or conventional loan, and now wish to refinance again with a VA loan at a lower interest rate. Under current law, these veterans could not have their previously used entitlement restored since they still own the home that secured the original VA loan. Therefore, most such veterans could not now obtain a VA loan in order to reduce their interest rate.

7.

Honorable G. V. (Sonny) Montgomery

We would have no objection to this provision if it were limited to interest rate reduction refinancing cases.

Section 5 of H.R. 5221 would change the standard for considering waiver of a debt established against a veteran as the result of foreclosure of a VA guaranteed loan. Currently, section 3102(b) of title 38, United States Code, permits waiver if "collection . . . would be against equity and good conscience." The proposed amendment would provide that VA could not consider solely a balancing of fault or the future ability of the veteran to repay the debt.

It is our impression that the purpose of this section is to liberalize the criteria for waiver of indebtedness, and our preliminary reading of the section does not convince us that, as drafted, it will accomplish what seems to be intended. While it is difficult to determine the exact intent of this section of the bill, our position is that veterans and all other Federal borrowers should be responsible for repaying their debts to the Government, and we should be very cautious when considering liberalizing waiver provisions.

Section 6 of the proposed legislation provides a sense of the Congress as to the use of auctions for selling VA acquired properties. This section recommends that VA refrain from disposing of such properties through auctions and instead concentrate its efforts on disposing of the properties through conventional methods of sale and, where appropriate, lease such properties with an option to purchase. This section would also require a report to Congress within 30 days after enactment containing an evaluation of the feasibility of the recommendations and any legislative action needed for their implementation.

VA had planned a more extensive use of auctions for the remainder of Fiscal Year 1988. However, the recently enacted supplemental appropriation for the Loan Guaranty Revolving Fund permitted us to reexamine the auction schedule. As a result of our review, we reduced the number of planned auctions and have resumed using our former auction criterion to authorize auctions; i.e., auctions will be used only in those locations where VA has significant numbers of older, hard-to-sell properties which have been in inventory for the longest periods of time and which have not been sold through the efforts of participating real estate brokers. The sale of properties through individually brokered sales will remain our principal method of selling properties.

8.

Honorable G. V. (Sonny) Montgomery

We have found the auction to be very effective in helping to reduce our older inventory. For example, at the end of Fiscal Year 1984, we had 6,370 properties which had been in inventory over 12 months. At the end of Fiscal Year 1987 we had only 3,403 properties in this category, a net reduction of 47 percent. Not all of these older properties were sold at auction, but auctions were very instrumental in this reduction.

The auction method is used by all the other major participants in the foreclosed property sales market. HUD, FNMA, FHLMC, and private sector banks and savings and loans all use the auction in their efforts to control increasing and aging inventory. Given the expense of managing properties over long periods of time, it seems unlikely that VA could recoup those expenses by waiting for property prices to rebound in economically depressed areas. In view of this, we do not think it prudent to have VA, alone, refrain from using that viable sales alternative.

Over 95 percent of our property sales during the last 3 years have been made through conventional methods. We believe that this demonstrates our concentration on the conventional sales methods. The leasing of properties with an option to purchase has long been within the discretionary authority of our regional offices. Such leasing is authorized for properties that are not readily salable under normal sales conditions. The most significant barrier to more widespread use of leases with options to purchase is that, in the near-term, they do not provide the same cash flow to the Revolving Fund as do sales. This can result in the need for greater congressional appropriations. In addition, when VA leases property, it may become subject to local landlord-tenant laws. Such laws may require VA to make costly repairs to bring the property up to code, giving VA an immediate negative cash flow with little hope of ever recovering these additional costs. In addition, rent control laws may limit our income and restrict our right to take the property out of the rental market.

VA estimates that enactment of H.R. 5221 would result in a first year cost of $181.5 million. The 5-year projection for H.R. 5221 is a $2.95 billion saving to the LGRF and a $3.24 billion loss to the MIF, resulting in a net cost of $290 million in budget authority. This assumes a continuation of the 1 percent funding fee under the LGRF.

9.

Honorable G. V. (Sonny) Montgomery

The following is a detailed cost projection for H.R. 5221:

	(In Millions of Dollars)				
	1990	1991	1992	1993	1994
Savings to the LGRF:					
Budget Authority	146.3	- 86.5	-586.1	-1,038.7	-1,383.1
Appropriation	146.3	- 36.3	-405.7	- 708.8	- 923.4
Proceeds from Loan Sales	. . .	- 50.2	-180.4	- 329.9	- 459.7
Cost of the MIF:					
Budget Authority	35.2	154.9	441.4	1,128.3	1,481.9
Appropriation	0.2	35.4	158.2	696.9	921.4
Proceeds from Loan Sales	. . .	50.2	180.4	329.9	459.7
Government Contribution (1/4 percent per loan for 3 years)	35.0	69.3	102.8	101.5	100.8
Net Change:	+181.5	+ 68.4	-144.7	+ 89.6	+ 98.8

The Office of Management and Budget advises that there is no objection from the standpoint of the Administration's program to the submission of this report on H.R. 5221 to the Congress.

Sincerely,

THOMAS K. TURNAGE
Administrator

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

TITLE 38—VETERANS' BENEFITS

* * * * * * *

PART III—READJUSTMENT AND RELATED BENEFITS

* * * * * * *

CHAPTER 37—HOUSING AND SMALL BUSINESS LOANS

SUBCHAPTER I—GENERAL

Sec.
1801. Definitions.

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SUBCHAPTER III—ADMINISTRATIVE PROVISIONS

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1824A. Mortgage indemnity fund.

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§ 1802. Basic entitlement

(a) * * *

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(b) In computing the aggregate amount of guaranty or insurance housing loan entitlement available to a veteran under this chapter, the Administrator may exclude the amount of guaranty or insurance housing loan entitlement used for any guaranteed, insured, or direct loan, if—

(1)(A) the property which secured the loan has been disposed of by the veteran or has been destroyed by fire or other natural hazard; and

(B) the loan has been repaid in full, or the Administrator has been released from liability as to the loan, or if the Administrator has suffered a loss on such loan, the loss has been paid in full; [or]

(2) a veteran-transferee has agreed to assume the outstanding balance on the loan and consented to the use of the veteran-transferee's entitlement, to the extent that the entitlement of the veteran-transferor had been used originally, in place of the veteran-transferor's for the guaranteed, insured, or direct loan, and the veteran-transferee otherwise meets the requirements of this chapter[.] *; or*

(3) the loan has been repaid in full.

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§ 1803. Basic provisions relating to loan guaranty

(a) * * *

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(e) Any veteran who pays a fee under section 1829 of this title, or is exempted under section 1829(c) from paying such fee, on or after the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1988 with respect to a housing loan (other than a loan made under section 1833(a) or a loan for which a fee is collected under section 1829(b)) shall have no liability to the Administrator with respect to the loan for any loss resulting from any default of the veteran.

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SUBCHAPTER III—ADMINISTRATIVE PROVISIONS

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§ 1824. Loan guaranty revolving fund

(a) * * *

(b) The Fund shall be available to the Administrator when so provided in appropriation Acts and within such limitations as may be included in such Acts, without fiscal year limitation, for all housing loan guaranty and insurance operations under this chapter, except administrative expenses *and the operations carried out with the Indemnity Fund established by section 1824A.* For purposes of this subsection, the term 'administrative expenses' shall not include expenses incurred by the Administrator for appraisals performed after February 1, 1986, on a contractual basis in connection with the liquidation, of housing loans guaranteed, insured, or made under this chapter.

(c) There shall be deposited in the Fund (1) by transfer from current and future appropriations for readjustment benefits such amounts as may be necessary to supplement the Fund in order to meet the requirements of the Fund, (2) amounts received by the Administrator as fees collected under section 1829 of this title *before the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1988, except that fees collected under subsection (b) of such section 1929 on or after such effective date with respect to loans which were originally guaranteed, made, or insured before such effective date shall also be deposited in the Fund,* and (3) all amounts now held or hereafter received by the Administrator incident to housing loan guaranty and insurance operations under this chapter *with respect to housing loans guaranteed or insured under this chapter before the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1988,* including but not limited to all collections of principal and interest and the proceeds from the use of property held or the sale of property disposed of.

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§ 1824A. Mortgage indemnity fund

(a) There is hereby established in the Treasury of the United States a revolving fund known as the Veterans' Administration Mortgage Indemnity Fund (hereinafter referred to as the "Indemnity Fund")

(b) The Indemnity Fund shall be available to the Administrator for all operations (other than administrative expenses) carried out with respect to guaranteed or insured housing loans for which a fee is collected under section 1829 of this title on or after the effective date of the Veterans' Home Loan Mortgage Indemnity Act of 1988, other than loans to which section 1814 of this title appears and which were originally guaranteed or insured before such effective date.

(c)(1) All fees collected under such section 1829 on or after such effective date shall be credited to the Indemnity Fund, other than fees collected with respect to loans to which section 1814 of this title applies and which are originally guaranteed or insured before such effective date.

(2) There shall also be credited to the Indemnity Fund—

(A) for each housing loan guaranteed or insured under this chapter for which a fee is collected under section 1829 of this title on or after such effective date an amount equal to 0.25 percent of the original amount of such loan for each of the three fiscal years beginning with the fiscal year in which such fee is collected;

(B) all collections of principal and interest and the proceeds from the use of property held, or from the sale of property disposed of, with respect to loans to which subsection (b) of this section applies; and

(C) all income from the investments described in subsection (d) of this section.

(d)(1) The Secretary of the Treasury shall invest the portion of the Indemnity Fund that is not required to meet current payments made from the Indemnity Fund, as determined by the Administrator, in obligations of the United States or in obligations guaranteed as to principal and interest by the United States.

(2) such obligations shall have maturities suitable to the needs of the Indemnity Fund, as determined by the Administrator, and shall bear interest at rates determined by the Secretary of the Treasury, taking into consideration current market yields on outstanding marketable obligations of the United States of comparable maturities.

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§ 1829. Loan fee

[(a) Except as provided in subsection (b) of this section, a fee shall be collected from each veteran obtaining a housing loan guaranteed, made, or insured under this chapter, and from each person obtaining a loan from the Administrator to finance the purchase of real property from the Administrator, and no such loan may be guaranteed, made, or insured under this chapter until the fee payable with respect to such loan has been remitted to the Administrator. The amount of the fee shall be one percent of the total loan

amount. The amount of the fee may be included in the loan and paid from the proceeds thereof.

[(b) A fee may not be collected under this section from a veteran who is receiving compensation (or who but for the receipt of retirement pay would be entitled to receive compensation) or from a surviving spouse of any veteran (including a person who died in the active military, naval, or air service) who died from a service-connected disability.]

§ 1829. Loan fee

(a)(1) Except as provided in subsections (c) and (d), a fee shall be collected from each veteran obtaining a housing loan guaranteed or insured under this chapter, and from each person obtaining a loan under section 1833(a), and no such loan may be guaranteed, made, or insured under this chapter until the fee payable under this section has been remitted to the Administrator.

(2) The amount of such fee shall be 1.25 percent of the total loan amount, except that—

(A) in the case of a loan made under section 1833(a), the amount of such fee shall be one percent of the total loan amount; and

(B) in the case of a guaranteed or insured loan for a purchase or construction with respect to which the veteran has made a downpayment of not less than 5 percent of the total purchase price or construction cost, the amount of such fee shall be 0.75 percent of the total loan amount.

(3) The amount of the fee may be included in the loan and paid from the proceeds thereof.

(b) Except as provided in subsections (c) and (d), a fee shall be collected from a person assuming a loan to which section 1814 of this title applies. The amount of the fee shall be equal to one-half of one percent of the balance of the loan on the date of the transfer of the property.

(c) A fee may not be collected under this section from a veteran who is receiving compensation (or who but for the receipt of retirement pay would be entitled to receive compensation) and whose disability is rated at not less than 30 percent or from a surviving spouse of any veteran (including a person who died in the active military, naval, or air service) who died from a service-connected disability.

(d) After September 30, 1989, a fee may not be collected under this section with respect to a loan made under section 1833(a) or to which section 1814 of this title applies.

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§ 1832. Procedure on default

(a)(1) In the event of default in the payment of any loan guaranteed under this chapter, the holder of the obligation shall notify the Administrator of such default. Upon receipt of such notice, the Administrator may, subject to subsection (c) of this section, pay to such holder the guaranty not in excess of the pro rata portion of the amount originally guaranteed. [If] *Except as provided in section 1803(e) if* the Administrator makes such a payment, the Ad-

ministrator shall be subrogated to the rights of the holder of the obligation to the extent of the amount paid on the guaranty.

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§ 1833. Property management.

(a)(1) * * *

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[(3)(A) Before October 1, 1989, notes evidencing such loans may be sold with or without recourse as determined by the Administrator, with respect to specific proposed sales of such notes, to be in the best interest of the effective functioning of the loan guaranty program under this chapter, taking into consideration the comparative cost-effectiveness of each type of sale. In comparing the cost-effectiveness of conducting a proposed sale of such notes with recourse or without recourse, the Administrator shall, based on available estimates regarding likely market conditions and other pertinent factors as of the time of the sale, determine and consider—

[(i) the average amount by which the selling price for such notes sold with recourse would exceed the selling price for such notes if sold without recourse; and

[(ii) the total cost of selling such notes with recourse, including—

[(I) any estimated discount or premium;

[(II) the projected cost, based on Veterans' Administration experience with the sale of notes evidencing vendee loans with recourse and the quality of the loans evidenced by the notes to be sold, of repurchasing defaulted notes;

[(III) the total servicing cost with respect to repurchased notes, including the costs of taxes and insurance, collecting monthly payments, servicing delinquent accounts, and terminating insoluble loans;

[(IV) the costs of managing and disposing of properties acquired as the result of defaults on such notes:

[(V) the loss or gain on resale of such properties; and

[(VI) any other cost determined appropriate by the Administrator,

[(B) Not later than 60 days after making any sale described in subparagraph (A) of this paragraph occurring before October 1, 1989, the Administrator shall submit to the Committees on Veterans' Affairs of the Senate and the House of Representatives a report describing—

[(i) the application of the provisions of such subparagraph, and each of the determinations required thereunder, in the case of such sale;

[(ii) the results of the sale in comparison to the anticipated results; and

[(iii) actions taken by the Administrator to facilitate the marketing of the notes involved.

[(C) Beginning on October 1, 1989, the Administrator may sell any note evidencing such a loan—

[(i) with recourse; or

[(ii) without recourse but only if the amount received is equal to an amount which is not less than the unpaid balance of such loan.]

(3) The Administrator may sell any note evidencing such a loan with or without recourse, but only if the amount received at the time of such sale is equal to amount which is not less than 90 percent of the unpaid balance of such loan.

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PART IV—GENERAL ADMINISTRATIVE PROVISIONS

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CHAPTER 53—SPECIAL PROVISIONS RELATING TO BENEFITS

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§ 3102. Waiver of recovery of claims by the United States

(a) * * *

(b) With respect to any loan guaranteed, insured, or made under chapter 37 of this title, the Administrator may waive payment of an indebtedness to the Veterans' Administration by the veteran (as defined in sections 101 and 1801), or the veterans' spouse, following default and loss of the property, where the Administrator determines that collection of such indebtedness would be against equity and good conscience. *The Administrator may not make a determination with respect to equity and good conscience solely on the basis of a balancing of fault or on whether the veteran might be able to repay the indebtedness.*

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